YAP SING HOCK HOLDINGS BHD. & ORS.

v.

CHUAH TEONG HOOI & ORS.

SUPREME COURT, KUALA LUMPUR
ABDUL HAMID OMAR LP
HARUN HASHIM SCJ
MOHD. YUSOFF MOHAMED SCJ
[SC CIVIL APPEAL NO. 02-62 OF 1989]
11 JULY 1990

COMPANY LAW: *Shares - Financial assistance for purchase or subscription - Debenture as security - Specific and floating charges - Existing and future assets - Personal and bank guarantee - Section 67(1) Companies Act.*

The 1st appellant executed a debenture with the 3rd respondent, the debenture being one of the securities provided in relation to 2 letters of guarantee from the 3rd respondent for the financing of the purchase by the 1st appellant of the entire share capital of 3 private companies. After initial discussions, the 1st applicant provided securities in the form of pledge of all its shares, a debenture and personal guarantee of its directors, the 2nd, 3rd and 4th appellant. On the date of repayment, the 1st appellant defaulted, the 3rd respondent paid under the 2 letters of guarantee and subsequently demanded immediate repayment from the 1st appellant. The 1st appellant failed to pay and the 3rd respondent exercised its rights under the debenture by appointing the 1st and 2nd respondents as managers and receivers.

The appellants sought a declaration that the debenture in question and the subsequent appointment of the 1st and 2nd respondents as managers and receivers under the debenture are null and void under s. 67(1) of the Companies Act 1965. The High Court did not grant the appellants' declaration and this is an appeal from the refusal.

Held:

[1] The entire exercise as contemplated in the two loan agreements the guarantees and the proposals as put forward to the Foreign Investments Committee and Bank Negara did not in any way involve the assets of the three companies to finance the purchase of their shares either directly or indirectly.

[2] The commercial reality of the transaction in the particular circumstances of this case is that the loans were secured on the existing assets of the 1st appellant.

[3] Although the prohibition against the giving of any financial assistance either directly or indirectly by a company in dealing with its own shares is wide, it does not prohibit a debenture creating a floating charge as in the present case.

[Appeal dismissed with costs.]

Cases referred to:
Wallersteiner v. Moir [1974] 1 WLR 991
Heald v. O'Connor [1972] 2 All ER 1105
Steen v. Law [1964] AC 287
Selangor United Rubber Estates v. Craddock (No. 3) [1968] 1 WLR 1555

Legislation referred to:
Companies Act 1965, s. 67(1)

For the appellants - K.S. Narayanan; M/s. K.S. Narayanan Associates
For the respondents - D.P. Naban; M/s. Skrine & Co.

JUDGMENT

Mohd. Yusoff Mohamed SCJ:

This is an appeal against the decision of Siti Norma J dismissing the appellants' originating motion seeking to declare the debenture executed by the 1st appellant and the appointment of the first and second respondents as receivers and managers thereunder are null and void by reason of illegality.

Mr. Narayanan, Counsel for the appellants, informed the Court at the outset that for the purpose of this appeal the appellants would rely on facts as found by the learned Judge and the documents produced before the Court.

For convenience, the facts as found by the learned Judge are reproduced hereunder:

> The only issue raised in this originating motion is whether a debenture executed by the 1st applicant with the 3rd respondent on 29 April 1985 is caught by s. 67(1) of the Companies Act 1965, (the Act). The debenture in question is one of the securities provided by the 1st applicant to secure 2 letters of guarantee from the 3rd respondent to finance the purchase by the 1st applicant of the entire share capital of 3 private companies, namely Lien Hoe Sawmill Co. Sdn. Bhd., Tee Bros, Enterprises Sdn. Bhd. and Seng Aik Co. Sdn. Bhd. (the 3 companies) for a consideration of RM46 million.
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> To finance the purchase, the 3rd respondent arranged syndicated loans from a consortium of financial institutions (the lenders) backed by its own guarantees. Initially, the 3rd respondent required the 1st applicant to provide the following securities to secure the bank guarantees it was prepared to provide:
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> 1. A pledge of all the shares of the 1st applicant to the 3rd respondent.
> 2. A deposit of title deeds of certain pieces of land belonging to the 3 companies together with charges-in-escrow over them in favour of the 3rd respondent.
> 3. An assignment of all the proceeds of sale of the assets of the 3 companies to the 3rd respondent.
> 4. Personal guarantees of the directors of the 1st applicant.

As regards repayment, the 3rd respondent had also requested that the sources for repayment should come from the cash fixed deposits and the proceeds of sale of the shares of the 3 companies.

However, acting on the legal advice that the securities asked for particularly those to be provided by the 3 companies are illegal transactions as contravening s. 67(1) of the Act, the securities that were finally given by the 1st applicant were (1) a pledge of all its shares, (2) a debenture, creating a specific and floating charge of all its assets, both present and future and (3) the personal guarantees of its directors, the 2nd - 4th applicants.

Under the debenture, the loans had to be repaid by the 1st applicant by 29 April 1986, failing which, the lenders would turn to the 3rd respondent for payment under the two bank guarantees.

The purchase price was duly settled by the 1st applicant on 29 April 1985 from loans extended by the lenders pursuant to two loan agreements executed by the 1st applicant with the lenders but on the date of repayment, the 1st applicant defaulted and the 3rd respondent was called

upon to pay under the two letters of guarantee. It did so and in order to recoup its losses, it demanded immediate repayment from the 1st applicant and following the latter's failure to comply with such demand, the 3rd respondent exercised its rights under the debenture by appointing managers and receivers, the 1st and 2nd respondents on 9 May 1986, to take possession of all the charged assets of the 1st applicant and generally to do all acts which the 1st applicant may have done in the ordinary conduct of its business.

Two years and four months after such appointment, the 1st applicant together with its directors and shareholders, the 2nd - 4th applicants have, through this originating motion, asked for a declaration, *inter alia*, that the debenture executed by the 1st applicant with the 3rd respondent and the subsequent appointment of the 1st and 2nd respondents as managers and receivers under the debenture, are null and void as contravening s. 67(1) of the Act. Section 67(1) states as follows:

> Except as is otherwise expressly provided by this Act no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase deal in or lend money on its own shares.

Under subsection (3), if there is any contravention of subsection (1), only the officer who is in default shall be guilty of an offence, the penalty for which is imprisonment for two years or a fine of RM10,000 or both.

After examining the facts of the case the learned Judge came to the following finding:

> It is my considered opinion that the only company that can be held responsible for contravening the statutory provision can only be the 3 companies and not the 1st applicant and to bring the 3 companies within the ambit of s. 67(1), the applicants must show that the 3 companies provided financial assistance in the purchase of their own shares by the 1st applicant. On the facts of the case before me, that financial assistance can only take the form of the 3 companies creating a debenture over their own assets in favour of the 3rd respondent.

We agree with the learned Judge's finding of fact that the 3rd respondent originally intended to include the assets of the three companies as security for the guarantee but acting on solicitor's advice it did not pursue with the negotiation as it contravened s. 67 of the Act.

There were several grounds advanced by the appellants in their memorandum of appeal but Mr. Narayanan wished to confine his argument to only one issue governing this appeal and that is:

> 3. The learned Judge after having sought to examine the 'commercial realities of the transactions' failed to conclude that on the facts of the case the granting of the said debenture by the 1st appellant is in contravention of the prohibitory provisions of s. 67(1) of the Companies Act.

In his submission Mr. Narayanan contended that the debenture executed by the 1st appellant with the 3rd respondent was in contravention of s. 67 of the Act by reason that, indirectly, the assets of the three companies were intended to be securities for the guarantees granted by the 3rd respondent. He submitted that the Court ought to examine the entire transaction in order to decide the question of commercial realities. He also referred to *Wallersteiner v. Moir* [1974] 1 WLR 991 and quoted Lord Denning MR on the historical aspect of s. 54 of the equivalent English Act and how the commercial realities were examined there, in these words:

That section was first introduced in the Act of 1929. It was enacted so as to deal with a mischief which was described by Lord Greene MR, in *In re V.G.M. Holdings Ltd.* [1942] Ch 235, 239:

> Those whose memories enable them to recall what had been happening after the last war for several years will remember that a very common form of transaction in connection with companies was one by which persons - call them financiers, speculators, or what you will - finding a company with a substantial cash balance or easily realisable assets such as war loan, bought up the whole or the greater part of the shares of the company for cash and so arranged matters that the purchase money which they then became bound to provide was advanced to them by the company whose shares they were acquiring, either out of its cash balance or by realisation of its liquid investments. That type of transaction was a common one, and it gave rise to great dissatisfaction and, in some cases, great scandals.

Lord Greene, MR, spoke those words in the year 1942. Since that time financiers have used more sophisticated methods. You have only to look at such cases as *Steen v. Law* [1964] AC 247 and *Selangor United Rubber Estates v. Craddock* (No.3) [1968] 1 WLR 1555 to see the devices which they use. Circular cheques come in very handy. So do puppet companies. The transactions are extremely complicated, but the end result is clear. You look to the company's money and see what has become of it. You look to the company's shares and see into whose hands they have got. You will then soon see if the company's money has been used to finance the purchase.

On the other hand, Mr. Naban, Counsel for the respondents, argued that the debenture was not given by the three companies directly or indirectly. Instead it was given by the 1st appellant. It is his contention that "company" referred to in s. 67(1) of the Act must mean the three companies and not the 1st appellant. Accordingly, it is for the appellants to show that the debenture was created by the three companies for s. 67(1) to apply. He cited *Heald v. O'Connor* [1972] 2 All ER 1105 to show that in that case the debenture was created by the company in which shares were bought. He argued that in this case it has nothing to do with the companies in which shares are bought. He also argued that the debenture in this case deals with the assets of the 1st appellant. He further argued that the basis of the application, namely, that the debenture is bad as it provides financial assistance by the three companies is without foundation.

What were in fact the commercial realities of this transaction?

We perceived from the facts and the documents produced that in the course of arranging for the financing of the acquisition of the three companies, the 1st appellant first obtained the approval of the Foreign Investments Committee on 18 December 1984. It also sought Bank Negara's approval to borrow from off-shore banks a sum not exceeding 20 million ringgit. In response to a query from Bank Negara, Asia International Merchant Bankers Bhd., on behalf of the 1st appellant, replied that repayment sources for the loan would be through inter-company borrowings from the Hong Huat Group of companies which is also controlled by Dato Yap Sing Hock himself, the alter ego of the 1st appellant. On that basis Bank Negara gave its approval on 24 April 1985.

Two consortiums of banks actually furnished the funds for the loan amounting to US$8 million and Malaysian 20 million ringgit. The two loan agreements were executed between the consortiums and the 1st appellant with the 3rd respondent as guarantor. On the very day the guarantees were issued on 29 April 1985, the 1st appellant drew-down the whole of the

loan sum from the two consortiums of banks. The funds were remitted by the banks direct to the 1st appellant and not through the 3rd respondent. In our view, the entire exercise as contemplated in the two loan agreements, the guarantees, the proposals as put forward to the Foreign Investment Committee and Bank Negara did not in any way involve the assets of the three companies to finance the purchase of their shares either directly or indirectly.

In the present case, on those facts, it is our considered judgment that commercial reality of the transaction in the particular circumstances of this case is that the loans were secured on the existing assets of the 1st appellant. The floating charge in respect of future assets was additional security to ensure due compliance of the loans and guarantee agreements. This is a normal banking practice. In any event, the debenture provides for additional security to be furnished when called upon by the 3rd respondent (see s. 3.04 of the guarantee agreement). This clause enabled the 3rd respondent to have access to the assets of the 1st appellant, whenever acquired without resorting to floating charge clause in the debenture. In our view, although the prohibition against the giving of any financial assistance either directly or indirectly by a company in dealing with its own shares is wide, it does not prohibit a debenture creating a floating charge as in the present case. For these reasons we would dismiss the appeal with costs. Deposit to respondents to account for taxed costs.

Also found at [1990] 2 CLJ 350